

## GRANTS, LIMITATIONS, KNOW-HOW, AND OTHER PERILS IN INTERNATIONAL LICENSING—SOME CONTEMPORARY ADVICE

STANLEY A. FREEDMAN\*

These days, after reading the cases<sup>1</sup> and the speeches of the new anti-patent antitrust activists in the Department of Justice,<sup>2</sup> it is hard to understand why anyone in his right mind licenses patents, trademarks or know-how to anyone else, domestic or foreign. The antitrust hostility and suspicion engendered by the very mention of the word "license" are themselves enough to blight the most innocent commercial hopes.

The principal, if not the only, legitimate purpose of licensing—so it seems from a reading of the recent literature—is to create, nurture, and bring to maturity a successful competitor. Any licensing arrangement that does not have that purpose and effect is quite likely to be considered illegal in context, if not illegal per se.

If that is the way the law is tending, then it can only be urged upon clients one and all the wisdom of seeking licenses from others but granting none themselves. Nor need clients be too choosy or prickly about the terms they are offered: the Justice Department and the courts stand ready to relieve them from unduly onerous stipulations that might restrain their ability to bite the hand that feeds them, and even to spare them the obligation to pay for what they get.<sup>3</sup>

Why should anyone today license others under his patents, know-how and trademarks? In the typical case, a client has, through long and hard experience, aided by judicious injections of applied research, learned how to make certain products in a superior way, or to use certain processes to achieve a commercially desirable result. Probably he has acquired one or more patents, and has some applications pending in the United States, plus a scattering of counterpart or parallel patents and applications in various likely and unlikely countries around the world. None of the patents is earth-shaking, but in various degrees each has value and, together with the client's all-important technology, can open the way to third parties to

---

\* Member of the Ohio Bar.

<sup>1</sup> E.g., *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969); *Painton & Co. v. Bourns, Inc.*, 309 F. Supp. 271 (S.D.N.Y. 1970), *rev'd*, 442 F.2d 216 (2d Cir. 1971).

<sup>2</sup> E.g., McLaren, *Patent Licenses and Antitrust Considerations*, 413 ANTITRUST TRADE REG. REP. X-11 (1969); Stern, *Antitrust Implications of Lear v. Adkins*, 15 ANTITRUST BULL. 663 (1970); Stern, *The Antitrust Status of Territorial Limitations in International Patent Licensing*, 498 ANTITRUST TRADE REG. REP. F-1 (1971); Donnem, *The Antitrust Attack on Restrictive Patent License Provisions*, 14 ANTITRUST BULL. 749 (1969).

<sup>3</sup> *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969); *Painton & Co. v. Bourns, Inc.*, 309 F. Supp. 271 (S.D.N.Y. 1970), *rev'd*, 442 F.2d 216 (2d Cir. 1971). What a foreign court may do, at the suit of a foreign party, is another matter. The knowledge that a clause which is an anathema to U. S. antitrust doctrine may be perfectly enforceable elsewhere helps keep the draftsman on the *qui vive*.

engage successfully in the client's business, to manufacture like products in the same superior way and to use the same processes to achieve a like commercially desirable result.

All of this has been achieved by years of effort and at considerable cost. It is an asset vital to the client's business but rarely represented at anything like its actual value on the client's balance sheet. It is responsible in no small measure for the client's record of earnings growth, and his position in the industry. The client knows it has value and in all likelihood he has had inquiries from others seeking to obtain licenses and has turned them down. He has been sufficiently concerned to guard it against unauthorized disclosure and to require his employees to sign confidentiality agreements and shrewd enough to bar his competitors from access to it.

Now he gets an inquiry from England, Germany or Japan. Limited resources of money and manpower, and a sufficiently challenging domestic market, have heretofore kept him from manufacturing overseas. He is aware, of course, that there are large markets to be served there; he is keenly interested in exploiting them. There is, therefore, an apparent opportunity to realize an immediate and continuing cash return on his accumulated know-how and patents and also to establish a foothold, a bridgehead, in a foreign market through a licensee.

The client may never have heard of the foreign firm before, but if the negotiations are successful and a license agreement is signed, more likely than not a cordial business relationship will arise. Purely technical requirements of trademark law will oblige the licensor to interest himself in the quality of products manufactured and sold by the licensee under the licensor's trademarks.<sup>4</sup> But over and above such considerations will be the commercial and cooperative ties that bind the parties, ranging from interchanges of technical personnel to royal visits of corporate executives and proud mention of the affiliation in annual reports to stockholders.

A license, in that typical situation, is more than a technical device by which permission to do something is given to one person by another who has the power to prohibit it. It is the core of a complex relationship, commercial in motivation, educational in concept, familial (and essentially non-competitive) in spirit. The licensor client expects to realize a specific and reasonably calculable cash return on what he has undertaken to license plus some incalculable future benefits from the extension of his influence and knowledge into new foreign markets. Somewhere down the road he envisions the possibility of a joint venture, an acquisition or an amalgamation which will make his participation in foreign markets an investment rather than just a contractual engagement. He does not expect his existing business to be taken away from him or to be directly challenged by a new competitor whom he has himself educated and trained in

---

<sup>4</sup> See, e.g., Ladas, *Problems of Licensing Abroad*, 1965 U. ILL. L.F. 411, 437.

his best and most up-to-date manufacturing techniques, in an already crowded home market. Indeed, he has already rejected requests for licenses by domestic competitors because he did not want to trade a short-term cash return for a long-term deterioration in his competitive position. So the licensor wants to arrive at an understanding with his prospective licensee, as explicit and enforceable as possible, limiting the licensee to his home territory, possibly reserving certain fields of use or customers to himself or other licensees and requiring the licensee to keep him abreast of any new developments he may make and to maintain the confidentiality of all information transmitted to him. In return the licensor is prepared to consider limitations on his own commercial activities outside the United States and to spread his compensation (or royalties) indefinitely into the rosy future.

What must one, as counselor, tell the client about the reasonableness of his expectations? The question has been posed broadly to obviate some easy threshold escapes from hard questions. Of course, if there is no direct and substantial effect reasonably foreseeable on United States commerce with foreign nations, there is not likely to be any Sherman Act problem. Analysis may likewise disclose no problems under the regulations of the Common Market, or the Japanese Fair Trade Commission, or such other national or regional antitrust norms as may be applicable. But assume no such ready assurances can be given, and the client's proposed course of action seems to offer sufficient promise of substantial success and impact to send one to a library for guidance. What should one look for and what is one likely to find?

In the first place, one needs to be quite clear as to the differences between a patent and know-how. A patent is a statutory right to exclude others from making, using and selling within the granting jurisdiction. This right to exclude is given certain attributes of property by the patent statutes: it may be assigned; a license may be granted under it as to all or part of the United States; a royalty may be charged for the license.<sup>5</sup> The invention or discovery claimed by the patent is disclosed therein for all to read. It has a life of 17 years. Its purpose is to encourage inventors to disclose their inventions and to contribute them to the public by giving the inventors the exclusive right to exploit the inventions during the statutory period. After the statutory period expires, anyone may use the invention free from any claims by the inventor.<sup>6</sup> The statute requires an invention to be of a high order to warrant patent protection,<sup>7</sup> and the patent, when it issues, is supposed to describe the invention clearly and with

---

<sup>5</sup> 35 U.S.C. § 261 (1964).

<sup>6</sup> 35 U.S.C. § 154 (1964); *Scott Paper Co. v. Marcalus Mfg. Co., Inc.*, 326 U.S. 249 (1945).

<sup>7</sup> 35 U.S.C. §§ 101-03 (1964); *Graham v. John Deere Co. of Kansas City*, 383 U.S. 1 (1966).

precision, particularly specifying the protected novelty.<sup>8</sup> Any attempt to extend the patent monopoly beyond its statutory limits—even by collecting royalties after its expiration<sup>9</sup> or by requiring the licensee to accept a package of patents<sup>10</sup>—is a misuse of the patent, and may constitute a violation of the Sherman Act.

Know-how, on the other hand, is a loose and variable term, not defined by statute, which comprehends the widest variety of commercially valuable information, tangible and intangible. Know-how is unpatented, in most cases is not patentable, and generally does not rise to the demimondaine dignity of a trade secret. It is valuable because it is not generally known and because knowledge of it can confer a commercial advantage. It is of uncertain dimensions and duration and is difficult to describe. Usually it is a by-product of the owner's struggle to succeed and therefore it represents substantial sweat and expense that would have to be duplicated by any new entrant into the owner's field. For that reason it commands a good price in the market; unlike the untried patent, know-how generally carries with it ample tangible testimonials as to its utility in achieving commercial success.

The common law recognizes the value inherent in confidential know-how and protects it from unauthorized disclosure through breach of fiduciary relationship or contractual obligation. But there is no assurance of monopoly; anyone who discovers the know-how without fraud or imposition is free to use it.<sup>11</sup>

It has been common, in the literature and cases as well as in the thinking of lawyers and businessmen, to amalgamate patents and know-how and to treat them, for licensing purposes, as substantially the same. True, it has generally been conceded that know-how is a lesser order of property than a patent and that restrictions imposed by know-how license can in no case exceed, and in some cases cannot duplicate, those permissible in a patent license of similar import.<sup>12</sup> But on balance it has been traditional to treat patents and know-how in licensing transactions as goose and gander.

Since, by common consent, it is highly unlikely that restrictive know-how licensing can rise higher than restrictive patent licensing, and since

---

<sup>8</sup> 35 U.S.C. § 154 (1964).

<sup>9</sup> *Brulotte v. Thys Co.*, 379 U.S. 29 (1964).

<sup>10</sup> *United States v. Loew's, Inc.*, 371 U.S. 38 (1962); *Rocform Corp. v. Acitelli-Standard Concrete Wall, Inc.*, 367 F.2d 678, 679-81 (6th Cir. 1966); *American Securit Co. v. Shatterproof Glass Corp.*, 268 F.2d 769 (3d Cir. 1959), *cert. denied*, 361 U.S. 902 (1959).

<sup>11</sup> See generally MacDonald, *Know-How Licensing and the Antitrust Laws*, 62 MICH. L. REV. 351 (1964).

<sup>12</sup> "All in all, it is not realistic to expect the courts to be more generous toward know-how than they are toward patents. If anything, they are likely to be more niggardly." Stedman, *Acquisition of Patents and Know-How by Grant, Fraud, Purchase and Grant-Back*, 12 ANTITRUST BULL. 199, 222 (1967); to the same effect, see Timberg, *The Impact of Antitrust Laws on Multinational Licensing and Franchising Arrangements*, 13 ANTITRUST BULL. 39, 49 (1968).

in any case there are remarkably few cases involving restricted licenses of know-how unmixed with patents or trademarks or both, and those rather old,<sup>13</sup> it will be useful to review briefly our standing in the patent-antitrust league. Those who follow the averages will have little difficulty anticipating the answer.

As everyone knows, the assumption that a pastiche of patents, trademarks and know-how could somehow explain and justify, as "ancillary" to the rights licensed, an elaborate international arrangement designed to eliminate or regulate competition among industrial giants came crashing to the floor in the late 1940's and early 1950's.<sup>14</sup> The cartel cases were enough to chill most notions of elaborate, permanent, anti-competitive international arrangements based upon, or including, these typical practices:

- (1) Price-fixing of patented and unpatented products.
- (2) Licenses requiring assignments or cross-licenses of *future* patent rights, on an exclusive basis.
- (3) Exclusive exchanges of know-how.
- (4) Territorial allocations of patent, trademark, and know-how rights.
- (5) Acknowledgements of the validity of existing and future patents and inventions.
- (6) Restrictions on export, or manufacture for export.

More recently, we have been reminded that a cooperative effort by international competitors to manipulate patent rights in order to achieve a territorial division of markets based on those rights, and to exclude foreign competition from the United States market, is a violation of § 1 of the Sherman Act.<sup>15</sup> The same conclusion followed from a cooperative international attempt, through the pooled or cross-licensed use of patents, to exclude an American manufacturer from foreign markets.<sup>16</sup> Furthermore, the Government has taken the same view of a long-term, extensive cooperative international arrangement based on an exchange of technologies and having the purpose and effect of allocating national markets, in its pending action against Westinghouse and Mitsubishi.<sup>17</sup>

---

<sup>13</sup> The principal know-how cases, sustaining reasonable territorial limitations in licenses between American and foreign companies, are *United States v. E. I. du Pont de Nemours & Co.*, 118 F. Supp. 41 (D. Del. 1953), *aff'd on other grounds*, 351 U.S. 377 (1956) and *Foundry Services, Inc. v. Beneflux Corp.*, 110 F. Supp. 857 (S.D.N.Y. 1953), *rev'd on other grounds*, 206 F.2d 214 (2d Cir. 1953). See Wolfe, *Restrictions in Know-How Agreements*, 12 ANTI-TRUST BULL. 749 (1967).

<sup>14</sup> *United States v. Holophane Co., Inc.*, 119 F. Supp. 114 (S.D. Ohio 1954), *aff'd*, 352 U.S. 903 (1956); *United States v. Imperial Chemical Industries, Ltd.*, 100 F. Supp. 504 (S.D.N.Y. 1951); *United States v. Timken Roller Bearing Co.*, 83 F. Supp. 284 (N.D. Ohio 1949); *aff'd*, 341 U.S. 593 (1951); *United States v. General Electric Co.*, 82 F. Supp. 753 (D.N.J. 1949); *United States v. General Electric Co.*, 80 F. Supp. 989 (S.D.N.Y. 1948); *United States v. National Lead Co.*, 63 F. Supp. 513 (S.D.N.Y. 1945), *aff'd*, 332 U.S. 319 (1947).

<sup>15</sup> *United States v. Singer Mfg. Co.*, 374 U.S. 174 (1963).

<sup>16</sup> *Zenith Radio Corp. v. Hazeltine Research Inc.*, 395 U.S. 100 (1969).

<sup>17</sup> *United States v. Washington Elec. Corp.*, Civil No. C-70-852 (N.D. Cal., filed April

Quite aside from those international trustbusting cases in the grand manner there has been a series of attacks on the patent citadel which has risen to such a crescendo as to be called by Marcus Hollabaugh "The Second Patent Crusade."<sup>18</sup> The theme is that of Richard W. McLaren, Assistant Attorney General in charge of the Antitrust Division of the Department of Justice, who announced in a June, 1969, speech:

In considering whether to attack a particular licensing provision or practice, we ask ourselves two fundamental questions. First, is the particular provision justifiable as necessary to the patentee's exploitation of his lawful monopoly? Second, are less restrictive alternatives which are more likely to foster competition available to the patentee? Where the answer to the first question is no, and to the second yes, we will consider bringing a case challenging the restriction involved.<sup>19</sup>

So rapid has the pace of change been that, as Tommy Austern has noted, "reporting the current legal rules on patent licensing is an ephemeral and hazardous undertaking."<sup>20</sup> Licensee estoppel, the ancient doctrine that a patent licensee is estopped to challenge the validity of the patent under which he is licensed, was invalidated by the Supreme Court in *Lear, Inc. v. Adkins*.<sup>21</sup>

Numerous other patent law doctrines, of varying antiquity and presumed legality, are presently in doubt quite apart from their presence in typical cartel cases, for example:

- (1) Field of use limitations;
- (2) Restrictions on form, manner or channels of distribution of sale of patent products;
- (3) Territorial and output limitations;
- (4) Single-licensee price fixing;
- (5) Royalty discrimination;

---

22, 1970). Developments in this case are being followed closely by the EEC Commission, which has announced its intention to intervene against any licensing agreements containing restrictive clauses between the companies involved and Common Market firms, 2 CCH COMM. MKT. REP. ¶ 9402 (1970).

<sup>18</sup> Hollabaugh, *The Scott Amendments v. The Second Patent Crusade*, 39 A.B.A. ANTITRUST L.J. 780 (1970). The tale is succinctly told in an article by White and Staubitz, *The Antitrust Attack on Patent Licensing—From Light Bulbs to Lear Jets*, 25 BUS. LAWYER 1725 (1970).

<sup>19</sup> McLaren, *Patent Licenses and Antitrust Considerations*, 413 ANTITRUST TRADE REG. REP. X-11, X-12 (1969). As noted in the article by White and Staubitz, *supra* note 18, this has been repeated, substantially verbatim, by Roland W. Donnem, formerly Director of Policy Planning for the Antitrust Division; Bruce B. Wilson, Special Assistant to Mr. McLaren; and Richard H. Stern, Chief of the newly organized Patent Unit in the Antitrust Division.

<sup>20</sup> Austern, *Fish Traps, Indians and Patents*, 12 ANTITRUST BULL. 225, 229 (1967).

<sup>21</sup> 395 U.S. 653 (1969). The rule applies equally to exclusive and non-exclusive licenses. *Beckman Instruments, Inc. v. Technical Developments Corp.*, 433 F.2d 55, 58 (7th Cir. 1970). Acknowledgment of patent validity and agreements not to contest the same during the term of the license agreement "or thereafter" were held (the patent having proven to be invalid) to have resulted in monopolization by the licensor in violation of the Sherman Act in *Bendix Corp. v. Balox, Inc.*, 321 F. Supp. 1095 (E.D. Wis. 1971), *on remand from* 421 F.2d 809 (7th Cir. 1970).

- (6) Package licensing;
- (7) Grant-backs (other than on a nonexclusive, royalty-paid basis); and
- (8) Contractual provisions which tend to inhibit the granting of future licenses to third parties.<sup>22</sup>

The Chairman of the Federal Trade Commission, in a paper presented in Cleveland before the Ohio State Bar Association's Antitrust Law Seminar on April 30, 1971, based his opposition to the so-called Scott Amendments<sup>23</sup> in part on the grounds that they would have the effect of vindicating certain of those practices, including field of use licensing. This determined onslaught makes it exceedingly dangerous to rely on last year's analysis, much less that of a few years back.<sup>24</sup>

How far we have come may be seen in two recent speeches relating to the validity of territorial limitations in foreign patent and know-how licenses, one by the general counsel of a major American chemical company, the other by Robert Stern, the Chief of the Antitrust Division's Patent Unit. It has been instinctive among patent antitrust lawyers for many years to distinguish between limitations imposed in the *grant* itself, and restrictions imposed by *agreement*, the former being considered unexceptionable, and the latter suspect under § 1 of the Sherman Act.<sup>25</sup> At this juncture it is pertinent to observe the directions which this doctrine is taking.

In an address before the Association of the Bar of the City of New

---

<sup>22</sup> Donnem, *The Antitrust Attack on Restrictive Patent License Provisions*, 14 ANTITRUST BULL. 749 (1969).

<sup>23</sup> Amendments Nos. 23 and 24 to S. 643, 92nd Cong., 1st Sess. (1971). Amendment No. 24 would, among other things, permit field of use and limited territorial patent licensing; prohibit assignors from challenging validity of assigned patents without returning the purchase price; and require licensees to surrender all future benefits under the license before challenging the validity of the licensed patent. It would also import the rule of reason into restrictive patent licensing (contrary to Mr. McLaren's test of necessity, *supra* note 19) by permitting the inclusion in patent licenses of restrictions "reasonable under the circumstances to secure the patent owner the full benefit of his invention and patent grant." The other amendment would prevent the Patent Act from being construed to preempt state or federal laws of contracts, trade secrets or unfair competition. See also remarks of Senator Scott and memoranda in support of the amendments, 506 ANTITRUST TRADE REG. REP. E-1 *et seq.* (1971); summary of comments on proposed amendments at the regional meeting of the Licensing Executives Society held in Washington on April 27, 1971, as reported in 510 ANTITRUST TRADE REG. REP. A-7 (1971). *Contra*, summary of testimony by Richard W. McLaren before the Senate Subcommittee on Patents, Trademarks and Copyrights of the Senate Judiciary Committee on May 11, 1971, 5 CCH TRADE REG. REP. ¶ 50,301 (1971).

<sup>24</sup> E.g., Barton, *Limitations on Territory, Field of Use, Quantity and Price in Know-How Agreements with Foreign Companies*, 12 ANTITRUST BULL. 243 (1967); MacDonald, *Know-How Licensing and the Antitrust Laws*, 62 MICH. L. REV. 351 (1964); Wolfe, *Restrictions in Know-How Agreements*, 12 ANTITRUST BULL. 749 (1967); cf. Stedman, *Legal Problems in the International and Domestic Licensing of Know-How*, 29 A.B.A. ANTITRUST L.J. 247 (1965).

<sup>25</sup> The syllogism is simple: a restricted grant of license is essentially a unilateral limited exercise of power conferred on the patentee by the patent laws, and therefore (by definition) not a restrictive agreement subject to the application of § 1 of the Sherman Act, 15 U.S.C. § 1 (1970).

York on May 1, 1969,<sup>26</sup> the corporate general counsel suggested that it is dangerous to grant a patent or know-how license to make, use and sell "in country X," albeit with no prohibitions whatever, because this might be subject to the interpretation (and might be understood by the parties to mean) that the licensee was restricted from using or selling the products elsewhere. He urged the inclusion of a clause explicitly stating that no limitation was intended on use or sale of the licensed product, or the product of the licensed process or know-how, at least within the United States. To prevent the interpretation that such a provision gives a license under any United States patent covering the product or process, the corporate general counsel suggested the addition of a clause to the effect that such provision is not intended to confer any rights under any United States patents.

Mr. Stern, in a speech before the Annual Meeting of the Antitrust Law Section of the New York State Bar Association on January 27, 1971,<sup>27</sup> asserted that there is no difference between a prohibition imposed on a licensee not to export to the United States and a failure to grant a license under a United States patent, and that the only question to be determined is whether the resulting restraint is undue.<sup>28</sup> This, he suggested, requires a "factor analysis" approach involving the size of the licensor and licensee, the amount of commerce involved, the package of patents licensed, the term of the agreement, whether there is cross-licensing, and the imposition of restrictions other than territorial. In the latter connection Mr. Stern asserted:

[T]he presence of such provisions as customer-class restrictions, field restrictions, quantity limits, and the like, will necessarily convert what the defendant alleges is a pure case of merely reserving domestic patent rights into something quite different.<sup>29</sup>

Mr. Stern generously concluded that, in the case of a single and nondominating patent, he is prepared to permit a U.S. patentee to *refrain* from licensing a foreign licensee under the parallel U.S. patent, without crying

---

<sup>26</sup> More, *U.S. Antitrust Laws and Territorial Provisions in Licensing Foreign Patents and Know-How for Foreign Use*, 24 RECORD OF N.Y.C.B.A. 512 (1969).

<sup>27</sup> 498 ANTITRUST TRADE REG. REP. F-1 (1971).

<sup>28</sup> Mr. Stern's analysis has perhaps been foreshadowed by the Common Market's concern over restraints of the intra-community trade resulting from parallel national trade-marks and patents. See the opinions of the Court of Justice of the European Communities in *Consten and Grundig v. E.E.C. Commission*, CCH COMM. MKT. REP. ¶ 8046 (1966) and *Sirena v. Eda*, CCH COMM. MKT. REP. ¶ 8101 (1971); both relating to the impropriety of using national trade-mark rights, acquired or licensed by agreement (and therefore within the reach of Article 85 of the Common Market Treaty), to impair EEC trade or distort EEC competition by preventing the free flow of goods across national boundaries, and *Parke, Davis & Co. v. Centaform*, CCH COMM. MKT. REP. ¶ 8054 (1968); to the effect, in part, that concerted use of parallel national patents to prevent intro-EEC competition would violate Article 85. See also Alexander, *The Establishment of the Common Market and the Problem of Parallel Patents*, 14 ANTITRUST BULL. 181 (1969).

<sup>29</sup> 498 ANTITRUST TRADE REG. REP. F-3 (1971).



foul. It is not possible to quarrel with his observation that "careful drafting makes a difference to the probable antitrust risks."<sup>30</sup>

In short, it appears that any attempt to rationalize competition by restrictive *patent* licensing, whether nationally or internationally, is a very uncertain undertaking (although a reservation must be entered as to the effect of the Scott Amendments to the Patent Act, if perchance they should be enacted in substantially their present form). There is no reason to suppose that restrictive *know-how* licensing will be treated any better.

Before one proceeds to advise a client, however, there remains the duty of examining the effects of *Lear, Inc. v. Adkins*, upon the whole notion of licensing know-how. In that case Lear sought to avoid paying royalties to Mr. Adkins under an agreement on the grounds that the licensed patent was invalid. Mr. Adkins replied, among other things, that Lear was estopped to challenge the validity of the patent and was obliged, in any case, to pay royalties irrespective of the validity of the patent. The only question presented for review was whether Lear was barred by the doctrine of licensee estoppel from challenging the validity of the patent and the enforceability of its obligation to pay royalties. Having concluded that the doctrine was inconsistent with federal patent policy, the Court overruled the line of cases which embodied licensee estoppel and reversed Mr. Adkins' judgment. However, in so doing, the Court also considered whether federal patent policy bars a State from enforcing a contract regulating access to an unpatented secret idea. The Court concluded that "the strong federal policy favoring the full and free use of ideas in the public domain" precluded any recovery by Adkins of royalties accruing *after patent issuance* if the patent should prove to be invalid. As to pre-patent issuance royalties, recognizing the problems of state as well as federal law involved, the Court remanded without attempting to define in even a limited way the extent, *if any*, to which the states may properly act to enforce the contractual rights of inventors of unpatented secret ideas.

In his celebrated separate opinion, joined by the Chief Justice and Justice Douglas, Justice Black conceded to any inventor the right to keep his discovery secret but asserted that any attempt to disclose it for contractual payments would frustrate the national policy expressed in the patent laws.<sup>31</sup> In other words, it was Justice Black's view that the disclosure of industrial or commercial know-how can only be an eleemosynary educational venture which could not, as a matter of federal patent policy, support the payment of a valuable consideration, much less, it seems clear, restrictions on its use.

Mr. Justice White also filed a separate opinion, in which he suggested,

---

<sup>30</sup> 498 ANTITRUST TRADE REG. REP. F-4 (1971).

<sup>31</sup> At least one writer considered, but discarded, a requirement that every innovation be disclosed, Doerfer, *The Limits on Trade Secret Law Imposed by Federal Patent and Antitrust Supremacy*, 80 HARV. L. REV. 1432 (1967).

among other things, that state law may still protect the inventor's claim for the value of whatever headstart his disclosures may have given the licensee, whether that value accrued *before* or *after* issuance of the patent. This view was, however, rejected by the majority opinion, which restricted the inventor's potential recovery solely to the period preceding patent issuance.

Mr. Stern, who was on the government's amicus brief in the case,<sup>32</sup> has since suggested:

The logical implication of *Lear v. Adkins* may well be that public policy forbids the enforcement of many private contractual arrangements that provide for patent-owner-like controls over unpatented matter such as technical information, trade secrets, or the subject matter of patent applications.<sup>33</sup>

He further suggested, based on that case, that restrictions invalid if based on patents are surely invalid if based on know-how or trade secrets. Restrictions of questionable status in the patent field—quantity limits, single licensee price-fixing, use restrictions, competitively injurious royalty discrimination and territorial limitations of the kind permitted by the patent statutes, are considered by Mr. Stern to be plainly invalid where applied to know-how. He points out that royalties are themselves a form of restraint, but concedes that the right to contract for and receive royalties in return for know-how has been left open by *Lear*. He suggests the test should be whether the know-how is valuable, and not already in the public domain.

One may wonder where the state law doctrines now stand upholding a right of action based upon the improper acquisition from the plaintiff of information in the public domain.<sup>34</sup> Judge Constance Baker Motley, in the Southern District of New York, appears to have taken Justice Black's opinion as setting that question to rest. In *Painton & Co. v. Bourns, Inc.*,<sup>35</sup> Bourns, a U.S. manufacturer, licensed Painton, an English company, with respect to Bourns' potentiometer know-how. A 1962 license agreement expired in 1968. The agreement contained no provisions relating to return or non-use of the know-how after termination. Bourns demanded that Painton cease to use the know-how and either return it, or pay for it. Painton brought a declaratory judgment action to establish its right to retain the know-how free from further payments. On cross motions for

---

<sup>32</sup> Close reading of the Government's amicus brief (*e.g.*, at 19, 20, 23-26) shows that the Government carefully distinguished the naked right of monopoly represented by a patent, which a licensee should be free to attack, from valuable trade secrets, which were assumed to be properly subject to protection under state law.

<sup>33</sup> Stern, *Antitrust Implications of Lear v. Adkins*, 15 ANTITRUST BULL. 663 (1970).

<sup>34</sup> See, *e.g.*, *Kirsel v. Duran*, 258 F. Supp. 845 (S.D.N.Y. 1964), *aff'd*, F.2d 179 (2d Cir. 1967) and *Smith v. Dravo Corp.*, 203 F.2d 369 (7th Cir. 1953); RESTATEMENT OF TORTS, §§ 757, 759 (1939).

<sup>35</sup> 309 F. Supp. 271 (S.D.N.Y. 1970), *rev'd*, 442 F.2d 216 (2d Cir. 1971).

summary judgment, Judge Motley held Painton free of any further obligation to Bourns with respect to unpatented materials. On the facts presented, the court could have rested on the fact that the expired contract contained no provision for return of the know-how. The court noted the availability of that ground for its decision under applicable California law. But the court also proclaimed, as its first alternative ground, the overriding policy of the patent laws (a) not to reward ideas which do not rise to a sufficiently high level of invention and (b) giving the public the benefit of full disclosure of all nonpatented ideas.<sup>36</sup>

As pointed out by Jack Lahr in a perceptive analysis,<sup>37</sup> these cases and comments fail to make an adequate analysis of the grounds validating the licensing of know-how and trade secrets for a consideration. It is inconceivable that all rights to sell know-how in consideration of compensation, whether in a lump sum or by way of royalties, will be destroyed by judicial fiat.<sup>38</sup> Nor will the scheme recently put forward by Kingman Brewster, once the grand panjandrum of United States international antitrust and now the President of Yale University, to collect tuition from undergraduates by levying a royalty on their future incomes for thirty-five years after graduation, likely be held invalid in the wake of *Lear*.<sup>39</sup>

Getting back to the original question, what can one tell a would-be licensor client about the reasonableness of his restrictive licensing expecta-

---

<sup>36</sup> In an earlier opinion, *Epstein v. Dennison Manufacturing Co.*, 314 F. Supp. 116, 125 (S.D.N.Y. 1969), written immediately subsequent to *Lear*, Judge Motley noted the divergent views of the majority and minority in that case and observed that the law in the Second Circuit "[l]ong prior to *Lear*, was that possessors of trade secrets or secret ideas could have limited recovery for the wrongful use of their ideas prior to the issuance of their patents. They could recover such damages as could be proved resulted from the wrongdoer getting to the market sooner (or gaining some advantage over his competitors) than would have been possible had the wrongdoer waited for the issuance of the patent." The opinion of the Court of Appeals, reversing *Painton*, makes it clear that that this remains the law in the Second Circuit. See also *Joseph Bancroft & Sons Co. v. M. Lowenstein & Sons, Inc.*, 50 F.R.D. 415, 421 (D. Del. 1970).

<sup>37</sup> Lahr, *The Federal Preemption Doctrine: Protection of Industrial Property and Its Relation to the Sherman Act*, 39 A.B.A. ANTITRUST L.J. 812 (1970).

<sup>38</sup> As noted in 84 HARV. L. REV. 477 (1970), at 482, and by the Second Circuit in reversing *Painton*, the District Court's opinion in that case would have the effect of causing manufacturers to keep know-how to themselves, with resulting economic inefficiency and encouragement to monopoly, 442 F.2d 216 (2d Cir. 1971). The Second Circuit also cited an amicus brief for the estimate that the rule adopted by the District Court in *Painton* might cost American licensors \$1 billion annually in lost know-how royalties from foreign licenses.

In any event, it seems that the wholesale invalidation of know-how licensing portended by Judge Motley's decision, hopefully in misplaced reliance on dicta and dissent in *Lear*, has been averted, and perhaps even that territorial restrictions and other restrictive clauses such as those contained in the Bourns-Painton agreement (including prohibitions against design changes by the licensee, payment of royalties after termination of the license agreement, required use of the licensor's trademark, prohibition of sale by the licensee of competitive products, and obligation to preserve the confidentiality of the know-how disclosed), which were described without comment in the Second Circuit's opinion, may still have some vitality.

<sup>39</sup> N.Y. Times, Jan. 31, 1971 at 1, col. 3 (city ed.); *id.* Feb. 6, 1971 at 26, col. 1. It has been suggested that the earlier, more limited view that a licensor may not license and collect royalty on technical information in the public domain might bar the collection of legal fees, Wolfe, *Restrictions in Know-How Agreements*, 12 ANTITRUST BULL. 749, 753 n.16 (1967).

tions? In the light of those cases, the announced (and pronounced) view of the Antitrust Division, the mournful prophecies of the academic Cassandras, the cautious comments of the high-priced private antitrust bar, and some personal experience with the negotiation and drafting of international patent/know-how/trademark agreements, it is suggested that one must answer along the following lines:

First, that a client must accept the risk—and even the probability—that the prospective licensee will sooner or later (depending on relevant economic and market factors) become a vigorous competitor in the client's home market, and that there is no effective way to stop this from happening. At the very least, the licensee, once well-established abroad, will constitute an obstacle to the client's own overseas expansion, or the client's choice of a new licensee if the first proves unsatisfactory.

Second, that know-how, once given, is, as a practical matter (if no longer as a matter of law under the district court's decision in the *Painton* case), irretrievable. There can be no going back, no return to the *status quo ante* for any reason, including termination of the license agreement and dissolution of the relationship between the parties. There is, indeed, some question as to the licensor's ability to enforce a confidentiality restriction upon the licensee, or even to keep the licensee from freely reselling or relicensing the know-how to third parties without the licensor's knowledge, consent, or participation in the proceeds.

Third—and this is a purely practical observation—that the obligations of a licensor in an international license relationship are generally more onerous and costly, and less profitable, to the licensor than is indicated by his most conservative calculations. In such cases the licensor suffers under a psychological compulsion to make the licensed know-how work and work well, regardless of cost and consequences, with adverse direct and indirect effects upon the licensor's own operations.

Fourth, that the long-term quasi-permanent international or multinational relationship of independent firms developing in parallel and non-competitive markets, cross-fertilizing each other with their respective new developments and respecting each others' market structures, all based upon the licensing concept, is increasingly a rarity, which can no longer be assured or relied upon.

Fifth, that the licensor must accept the proposition that his patent and technology package has a finite and limited value, realizable over the short or medium term, and any longer-term benefits that may flow from licensing it are likely to be serendipitous.

Sixth, that the licensor must be prepared to meet the demands of his licensee for reasonable protection from competition, without transgressing applicable law or stultifying his own ability to compete, directly or through another licensee, in the licensee's home market.

The prospect, therefore, is by no means altogether inviting. The client is faced at the outset with Hobson's choice: either he must keep his hands in his pockets or he must extend them to his prospective licensee substantially without restriction or qualification. In the present state of the law, it is perhaps still permissible for nondominant licensors to license non-competitors, subject to short term territorial limitations.<sup>40</sup> The recommendation, a decade ago, of Kingman Brewster, still seems viable:

[P]resumptive legality designed to give more certain scope to know-how licensing should be satisfied if the information transferred were of demonstrable productive value, if the restrained recipient were not a pre-existing actual or potential competitor in the American market, and if the agreement's restraints had a terminal date short of ten years.<sup>41</sup>

It will happen in most cases, of course, that the licensee will not be in a position to compete actively in the American market during the period necessary for him to digest the know-how and put it to effective use in his own operations, and it is only thereafter, when the permissible period of restriction runs out, that the real competitive threat will arise.

Territorial restrictions imposed by economic realities may be every bit as effective as restrictions imposed by limited grant or agreement. A licensee in an underdeveloped country is less likely, on the whole, to be a near-term potential competitor in the United States market than a developed-country licensee. The higher the degree of technology involved, and the greater the requirements of the underdeveloped country, the more correct this will be. The nature of the product to be manufactured by use of the know-how may also affect the potentiality of the competitive threat. High freight and duty barriers still operate as obstacles to effective competition. And the requirement that the licensee pay royalties to the licensor necessarily adds to this competitive burden and enhances the competitive position of the licensor.

There are several techniques which may be permissible for mitigating the harsh consequences of "putting a gun" in the hands of the licensee-competitor and inviting him to shoot the licensor with it, to use Professor Stedman's image.<sup>42</sup> In an industry characterized by the rapid obsolescence of technology, the transmittal of information can be limited to that current on the making of the license. By the time this information expires, the licensor should be in a superior competitive position. Of course, such a solution may bar a requirement that the licensee disclose and license

<sup>40</sup> The EEC Commission recently announced that it proposed to approve a patent and trademark license between a French licensor and a Japanese licensee whereby the latter would be restricted to manufacturing and selling in Japan. The Commission did not disclose the duration of the agreement, 13 E.E.C.J.O., No. C144 (Dec. 5, 1970) at 8; 2 CCH COMM. MKT. REP. ¶ 9400 (1970).

<sup>41</sup> See BREWSTER, *ANTITRUST AND AMERICAN BUSINESS ABROAD* 450 (1958).

<sup>42</sup> *Legal Problems in the International and Domestic Licensing of Know-How*, 29 A.B.A. ANTITRUST L.J. 247 (1965).

improvements back to the licensor.<sup>43</sup> Alternatively, the license can provide for a full exchange of know-how during a limited term followed by a period with no such exchange, a tapering off of royalties, decreasing by, for example, 1 percent per year for a period of four years, and the right to enter into new and additional license agreements in the territory. This will help to cushion the inevitable competitive confrontation, and give the licensor an opportunity, on its part, to engage in competition with the licensee in the latter's home market, either directly or through other licensees.

A practical comment may be in order here: since in most cases the licensor's contribution of know-how is substantially completed in the early months after the signing of a license, and it is primarily the licensee who must perform thereafter during the remaining term of the license, a close look should be given by licensor's counsel to the form of *force majeure* clause too often uncritically included in license agreements. It is usually not intended that the licensee's obligation to pay royalties, for example, be readily suspended as a result of any of the perils customarily inserted in such clauses; and the licensor will not long need the protections such clauses afford. On the other hand, one should take pains to include language broad enough to extricate a client if there are sound antitrust reasons to do so, sparing him (and his counsel) the embarrassment of being under United States compulsion not to do something which a foreign jurisdiction insists upon.

Finally, it may be possible to shift the problem area from the restrictive-licensing field to the joint venture field, perhaps with some diminution in exposure to antitrust attack. If the licensor is an investor-participant in a joint venture company, to which runs an unrestricted license, he may cast his vote as shareholder or director for or against proposed commercial or industrial activities on the part of the licensee without flourishing any contractual muscle. International joint ventures pose problems of their own, to be sure, but they are less likely to raise the threshold antitrust problems increasingly common in the licensing area.<sup>44</sup> In a joint venture situation, it is not unusual for the foreign joint venturer to demand an agreement from the licensor not to compete, or permit other licensees to compete, with the joint venture. Assuming a significant impact on United States foreign commerce, agreement with such a demand is plainly perilous. It may be possible to reduce (but not necessarily eliminate) the antitrust hazard by offering, in lieu of such a commitment, a buy-out option to the foreign joint venturer in the event of such competition.

---

<sup>43</sup> Note the E.E.C. position that nonexclusive grantbacks on improvements and know-how are valid only where the licensor undertakes a mutual obligation, *Official Notice on Patent Licensing Arrangements*, 1 CCH COMM. MKT. REP. ¶ 2698 (1971).

<sup>44</sup> See the discussion in More, *U. S. Antitrust Laws and Territorial Provisions in Licensing Foreign Patents and Know-How for Foreign Use*, 24 RECORD OF N.Y.C.B.A. 512, 518 (1969).

While it may be claimed that the existence of the option operates to discourage competition by the licensor, particularly where the terms of buy-out are punitive, at least it avoids the stigma of explicit agreement.

Where a client embarks on a program of multi-national parallel know-how licensing agreements, particular care is required. The Common Market has recognized the hazards implicit in such programs by refusing to exclude from *prima facie* applicability of Article 85 paragraph 1 of the Treaty of Rome agreements relating to joint patents, reciprocal licenses and multiple parallel licenses.<sup>45</sup> There is undoubted social and economic utility in the practice of exchanging information on technological developments among a licensor and its multinational licensees, so that all may freely practice the latest and most efficient methods. On the other hand, it is unlikely that the participants would be quite so willing to participate—assuming that they are actual or potential competitors in each other's home markets—without an understanding, express or implied, that they will respect those exclusive territories, as well as cooperate to hinder the entrance of newcomers into their field of business.

The demands of foreign licensees or licensors to be free from competitive conflict are a separate problem, albeit governed by the same general principles. It is one thing to preach restraint in the imposition of restraints to one's American client; it is something else to persuade a non-American and his non-American lawyer that one is not wearing a sanctimonious cloak of righteousness in so doing in order to hide one's real ulterior competitive purposes. Where the non-American seeks to license his know-how in the United States, the prospect of American long-arm antitrust jurisdiction over him, drawn from the recent spate of patent cases, may suffice to make him a willing listener.<sup>46</sup> If he nonetheless persists in demanding the imposition of restrictions which alarm one's better judgment, and a client would rather accept the risk than lose the bargain, there may, in some cases at least, be a certain utility in requiring the foreign licensor to assert in writing that the desired restrictions are being imposed as a condition of the license or to record a client's objections to them. This procedure will not help in cases of illegal market division, where a client shares in the resulting benefits,<sup>47</sup> but may be significant where a client is more the victim than the participant.<sup>48</sup> Where the foreign licensor requires a client to

---

<sup>45</sup> Official Notice on Patent Licensing Agreements, 1 CCH COMM. MKT. REP. ¶ 2698 (1971).

<sup>46</sup> Wallace, *Multinational Patent and Know-How Arrangements*, 39 A.B.A. ANTITRUST L.J. 791 (1970).

<sup>47</sup> See, e.g., *United States v. National Lead Co.*, 63 F. Supp. 513, 531 (S.D.N.Y. 1945), *aff'd*, 332 U.S. 319 (1947); *United States v. General Electric Co.*, 82 F. Supp. 753, 883 (D. N.J. 1949).

<sup>48</sup> Cf. *Zenith Radio Corp. v. Hazeltine Research Ind.*, 395 U.S. 100, 139 (1969); *Plastic Contact Lens Co. v. Frontier of the Northeast*, CCH TRADE REG. REP. (Trade Cas.) ¶ 73,544 (2d Cir. 1971).

agree not to export into the licensor's home market or elsewhere, on a permanent basis, one may find it useful, in negotiation, to offer to submit the proposal to the Antitrust Division for an opinion as to its legality—a ploy which must be weighed against the likelihood that the proposed licensor will promptly conclude the negotiations.<sup>49</sup>

In sum advice to a client comes down to this:

(1) License sparingly, in special situations, and only for excellent reasons—for example, where there is no other way to exploit a market; where the licensor stands to gain from a general advance in the art; in order to create a demand for other products marketed by the licensor; where there is little practical likelihood that the licensee will become a competitor; or for a very substantial return.

(2) Do not count on establishing a long-term mutually protective relationship in licensor-licensee form. Accept the license as a short-term affair, and discount the romantic ever-after.

(3) Negotiate the highest price possible, to be paid at the outset or over the short pull, in plain recognition of the hidden costs of licensing and a client's inability in law and fact to obtain lasting, effective protection from the licensee's competition.

If this makes a license negotiation into a tougher ball game than usual, it offers the advantage, if successful, of putting ready cash into a client's hands at the very outset, and that is likely to be gratifying both to him and his attorney.

---

<sup>49</sup> Cf. Rifkind, J., in *United States v. National Lead Company*, 63 F. Supp. 513, 531 (S.D.N.Y. 1945), *aff'd*, 332 U.S. 319 (1947): "Perhaps the answer is that DP, having discovered the conspiracy, should have asked the Attorney General to break it up. Confessedly, the chances of DP getting NL's patents and know-how after such a hostile act would be, to say the least, dubious. But in any event the courts may not validate unlawful conduct because in a particular instance there may be social losses involved in enforcing the law."